Japan announces “new dimension” in quantitative easing

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The Bank of Japan’s decision, announced on Thursday, to engage in what it described as a “massive” government bond-buying program signifies an escalation in the so-called global currency wars.

The unprecedented measures have been justified as a measure to boost the domestic economy and end the deflation that has gripped the Japanese economy for close to two decades. At the same time, however, they will depress the value of the Japanese yen in international currency markets.

Under the plan, described by one commentator as Japan’s “shock and awe,” the Bank of Japan (BoJ) said it would double Japan’s monetary base from Y135 trillion ($US1.43 trillion) to Y270 trillion in two years. This will be achieved by stepped-up purchases of long-term government bonds, lifting the average maturity of its holdings from three to seven years.

The BoJ will expand its balance sheet by the equivalent of 1 percent of gross domestic product (GDP) every month for the remainder of this year and by 1.1 percent per month in 2014. This is around double the rate of expansion of the US Federal Reserve’s holdings, which are growing by about 0.54 percent of GDP each month through the US Fed’s quantitative easing program.

Japan’s new measures were announced after the first meeting of the nine-member board of governors of the BoJ under newly-appointed governor Haruhiko Kuroda.

Kuroda was installed with a mandate to implement recently elected Japanese Prime Minister Shinzo Abe’s plan to lift Japan’s inflation rate to 2 percent per year. The fall in Japanese prices since the collapse of the country’s stockmarket and property bubble at the beginning of the 1990s has meant that, in money terms, Japan’s GDP was lower in 2012 than it was 20 years earlier.

While Abe insisted on the policy, there were doubts that the board of governors would agree to the switch, which targets longer-dated bonds. Previously the BoJ has confined its intervention to the short-term end of the market and had been reluctant to carry out massive quantitative easing.

But the “regime change” led by Kuroda was introduced with only a single dissenting voice on one aspect of the new policy.

Announcing the changes, the BoJ said it aimed to create a 2 percent inflation rate “at the earliest possible time.” Kuroda stated: “This is taking monetary easing into an entirely new dimension.”

Discarding the previous policy, which had been labelled as too cautious, Kuroda said: “Incremental steps of the kind we’ve seen so far weren’t going to get us out of deflation. I’m certain we have now adopted all the policies we can think of to meet the 2 percent price target.”

If prices did not start to rise as expected, Kuroda said the bank “would not hesitate” to increase its easing program. He criticised the previous policy for being too fearful of the possibility of igniting runaway inflation.

While generally welcomed in financial circles, there are anxieties about what the new policy—described by Kuroda as “unprecedented”—will bring. One concern is that the central bank’s massive purchases of government bonds will spark fears among investors that government debt, already the highest in the world at around 240 percent of GDP, will never be wound back. If panic took hold, this could lead to a rise in interest rates—in opposition to the intended effects of the policy—and to a fiscal collapse.

Kuroda acknowledged the risks but insisted that they should not prevent the BoJ from acting. “We have debated the side effects but we are currently not concerned that long-term interest rates might spike, or conversely, that there would be an asset bubble [a result of low interest rates]," he said. "That risks exist should not hold us back from pursuing much-needed monetary easing. We will keep in mind those risks, but push ahead."

One significant feature of the decision was its "go it alone" character. It appears that the US Federal Reserve Board, the Bank of England and the European Central Bank, all of which are engaged in their own versions of quantitative easing, were not even informed of the impending decision.

Financial Times columnist Gavyn Davies highlighted the scale of the operation.

"In effect," he wrote, "the new governor … has imported into Japan the whole of the Federal Reserve's post-Lehman balance sheet strategy, and he will implement it in under two years, instead of the five or more years taken by the Fed. The doubling in the Japanese monetary base over a period of 21 months is in itself remarkable. Taken together with the extension of the duration of bonds purchased from less than 3 years to an average of 7 years, the injection becomes of historic proportions."

The decision will have significant international consequences. It effectively blows out of the water the decisions taken at the February meeting of the G7 nations that countries should not undertake currency devaluations in order to improve their position in export markets.

Notwithstanding the claims by Japan that the measures are aimed at reviving the domestic economy, they will push down the value of the yen. The announcement had an immediate impact on currency markets. The yen fell against the US dollar, bringing to an end its short-term rise following the Cyprus crisis.

Since last June, the yen has already fallen by 22 percent and 24 percent against the US and Australian dollars respectively. One of the countries being significantly impacted is South Korea, where major electronics firms are in direct competition with Japanese companies for global markets.

Over and above the effect of the decision on the currency wars, the new BoJ policy points to the mounting instability of the international monetary system and the deepening crisis of global capitalism.

Decisions are now being undertaken which only a few years ago would have been ruled out as creating the conditions for a future financial catastrophe. Such is the state of the global economy that central bankers, once the bastions of financial conservatism, are operating according to the maxim: après moi le déluge.